



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA

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In the Matter of the Application of Southern)
California Gas Company (U 904 G), San Diego)
Gas & Electric Company (U 902-G), and Southern)
California Edison Company (U338-E) for)
Approval of Changes to Natural Gas Operations)
and Service Offerings)
_____)

A. 06-08-026

REPLY BRIEF OF SOUTHERN CALIFORNIA EDISON COMPANY (U338-E)

DOUGLAS K. PORTER
GLORIA M. ING
Attorneys for
SOUTHERN CALIFORNIA EDISON COMPANY

2244 Walnut Grove Avenue
Post Office Box 800
Rosemead, California 91770
Telephone:(626) 302-1999
Facsimile:(626) 302-3990
Gloria.Ing@sce.com

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I.

INTRODUCTION

Pursuant to the procedural schedule set by Administrative Law Judge Pulsifer in the above-referenced proceeding, Southern California Edison Company (“SCE”) hereby submits its Reply Brief, which urges the Commission to approve the changes to the operational practices and services sought by Southern California Gas Company (“SoCalGas”) and San Diego Gas and Electric Company (“SDG&E”) in this application. Such changes were agreed to in the May 30, 2006 settlement agreement between SCE, SoCalGas, and SDG&E (referred to herein as the “Omnibus Settlement Agreement”) and in the January 4, 2006 agreement between SoCalGas, SDG&E, Sempra Energy, Sempra Energy Affiliates, and the class action plaintiffs in what is commonly referred to as the Continental Forge class action lawsuit (hereinafter referred to as the “Continental Forge Settlement Agreement”). SCE urges the Commission to approve the reforms as a package because they represent a balance of interests designed to benefit all customers by bringing about necessary market reforms. The Commission should reject the efforts by various parties in this proceeding to modify the proposed tariff changes because they would run the risk

in creating unbalanced market reforms and would likely have unintended consequences to the detriment of all ratepayers.

SCE provides some general comments in response to the opening briefs filed by parties and then addresses specific positions raised by individual parties.

II.

THIS APPLICATION CONTAINS A BALANCED PACKAGE OF MARKET REFORMS AND THE COMMISSION SHOULD ADOPT THE AGREEMENT AS A WHOLE

As indicated above, the Commission should reject the individual efforts of the various parties in this proceeding to change individual pieces of the proposed tariff changes for their own self interest. SCE urges the Commission to adopt the proposed changes to the operational practices and services offered by SoCalGas and SDG&E presented in both the Omnibus Settlement Agreement and the Continental Forge Settlement Agreement. SCE believes these proposed changes will lead to a more transparent and competitive natural gas market in Southern California. SCE believes that the testimony and evidence in this proceeding demonstrate that the market reforms embodied in the proposed tariff changes put forward by SoCalGas and SDG&E in this application will reduce costs for SCE's ratepayers and ultimately benefit the California natural gas market as a whole. Commission approval of these reforms will, among other things, result in:

- More efficient and competitive intrastate transmission and storage markets.
- More equitable and efficient balancing rules.
- Increased market transparency and information disclosure.
- Increased efficiency and reliability of the gas infrastructure system that serves southern California.

In summary, approval of the Applicants' proposed changes to the operational practices of SoCalGas and SDG&E will result in a significant step toward ensuring in the future that the market for natural gas in southern California will be more efficient and transparent.

As indicated in SCE's Opening Brief,¹ as with any settlement agreement, the Omnibus Settlement Agreement represents a balance of interests and a compromise among the parties on various issues. The combined operational and market reforms included in this application as a result of the Omnibus Settlement Agreement and the Continental Forge Settlement Agreement will result, on balance, in a natural gas market that will benefit all natural gas customers in California. The proposed operational and market reforms that applicants have proffered for the Commission's approval in this matter were carefully considered by the applicants as a package of reforms and the Commission should reject any attempt by parties to pick and choose individual pieces of the proposed operational and market reforms that could run the risk of creating unbalanced and unintended consequences and/or market reforms shortcomings. For example, it would be unwise for the Commission to adopt DRA's proposal to maintain a higher storage reservation for core customers than that proposed in the application (even if it did provide a benefit to core customers as DRA believes, although SCE disagrees²) because it would change the delicate balance of operational reforms and market reforms offered up by this application. Given the disparate positions advocated individually by each of the applicants herein in proceedings before the Commission over the years as to the proper structure of the natural gas market in California, SCE respectfully requests that the Commission acknowledge and honor the extraordinary efforts of each of the applicants to fashion a set of market reforms for the Commission consideration herein that evaluates the impacts on core and noncore customers alike and adopt these proposed changes as a package.

As indicated by SCE, the market reforms proposed by this application are a significant step in the right direction. The proposed operational changes and market reforms do not purport to resolve all the disputed issues in the natural gas market, nor do they preclude other reforms from being considered in the future. For example, the Southern California Generation Coalition's ("SCGC") proposal that the allocation of costs for unbundled storage revenues

¹ SCE's Opening Brief, pp. 3-4.

² SCE's Opening Brief, Section IV.

(which is currently split between ratepayers at 70% and shareholders at 30%) mirror the allocation of revenues (which is split between ratepayers and shareholders equally)³ is not covered in the settlement agreements but should most certainly be considered in SoCalGas' next biennial cost allocation proceeding (to be filed no later than December 2007). However, at this time, the operational and market reforms proposed in this application should be adopted now because they are a significant step in the right direction, they address years of litigation before the Commission, and they would significantly improve the efficiency and transparency of the natural gas market.

A. The Settlement Agreement Reflects The Delicate Balancing Of A Multiple Of Interests

In DRA's Opening Comments, DRA expressed concern regarding not being a party to the negotiations on the Omnibus Settlement Agreement.⁴ DRA finds fault with SoCalGas, SDG&E, and SCE – all utilities regulated by the Commission – for having a “utility” perspective.⁵ Citing Public Utilities Code Section 309.5(a), DRA wrongly suggests that DRA is the sole party that can represent ratepayer interests in this proceeding.⁶ Furthermore, notwithstanding the statute's mandate that DRA act as an advocate for all public utilities customers (both core and noncore interests), DRA's apparent one-sided customer view is contrary to the Applicants' efforts to create a settlement that benefits all customers.

But, DRA (and TURN) are not the sole advocates with a demonstrated concern for core customer's welfare.⁷ The Applicants' commitment to serve all of its customers is summarized by SoCalGas/SDG&E witness Morrow at the evidentiary hearings:

³ SCGC's Opening Brief, Section I.G.

⁴ DRA's Opening Brief, pp. 4-6.

⁵ DRA's Opening Brief, p. 4.

⁶ DRA's Opening Brief, p. 5. Public Utilities Code Section 309.5(a) provides that “There is within the commission a division to represent the interests of public utility customers and subscribers within the jurisdiction of the commission. The goal of the division shall be to obtain the lowest possible rate for service consistent with reliable and safe service levels.”

⁷ Tr., Vol. 7, p. 1078, line 21 through p 1079 line 8.

“I think very clearly, both companies were looking for solutions that would be beneficial to the customers. They have an obligation to serve. And in our best judgment we put together a package that we are submitting to the Commission for their approval providing DRA an opportunity to comment on and advocate its positions, of course. But we do think the package in total provides benefits to customers. No individual provision in this proposal do we believe provides negative benefits to customers. We think they are at least neutral or positive. So in our judgment we thought it was a well thought out package, resolved many issues and would provide us the ability to go forward.”⁸

Contrary to DRA’s blatantly wrong assertion that the utility’s primary perspective and obligation is its fiduciary duty to its shareholders,⁹ Mr. Morrow further emphasized:

“[W]e have an obligation to serve our customers. That’s pretty ingrained. Certainly we are investor-owned utilities and have obligations to our shareholders as well. But our obligations are contingent on our ability to serve our customers and meet those obligations as set forth by the Commission.”¹⁰

Further, the Commission should be mindful that SCE, SoCalGas, and SDG&E exercise their duty every day as public utilities to provide reliable service to all of their customers (core and noncore) and to provide such service to all of their customers.¹¹ The parties to the Continental Forge Settlement Agreement and the Omnibus Settlement Agreement represent a broad spectrum of gas and electricity consumers, and their negotiation and execution of these settlement agreements reflects the delicate balancing of the multiple interests. While the Commission is not obliged to consider these proffered operational changes and market reforms as a package, SCE submits that the Commission would gain the greatest benefit from the efforts of the Applicants and the other settling parties to reflect this balance of interests if it adopted all of the reforms submitted through this application.

In the final analysis, approval of this application should not rest on questions concerning the strengths or weaknesses of the settlement process. This application is about establishing important market reforms. How the reforms were arrived at is an interesting artifact of history; it

⁸ Tr., Vol. 3, pp. 427-428 (SoCalGas/SDG&E, Morrow).

⁹ DRA’s Opening Brief, p. 4.

¹⁰ Tr., Vol. 3, pp. 428 (SoCalGas/SDG&E, Morrow).

¹¹ See Exhibit 71, direct Testimony of Sabino (DRA), page 5 (citing Public Utilities Code section 451).

is not the issue before the Commission at this time. And the evidence in this proceeding clearly indicates that the proposed market reforms themselves, taken as a whole, will result in important improvements to the natural gas market in Southern California.

III.

THE COMMISSION SHOULD SET THE COMBINED CORE INVENTORY LEVEL AT 70 BCF

A. DRA's Proposal is One-Sided And Would Upset The Balance Struck In The Omnibus Settlement Agreement

One market reform for which approval is sought in this application is the proposal to set the combined core inventory level at 70 Bcf.¹² SoCalGas has testified that, with the combined SoCalGas and SDG&E core procurement portfolios and gas acquisition management, it could serve the additional SDG&E load (which would be an addition of approximately 13-15%) without jeopardizing core reliability.¹³ Noncore customers (as well as potentially core), who have a need for storage, and who the Commission has strongly encouraged to increase their use of storage¹⁴ could have market access to the approximately 13 Bcf of now excess storage through the unbundled storage program.

DRA's proposal that the set aside for core storage inventory level (along with the corresponding proposed injection and withdrawal levels) should basically remain the sum of the SoCalGas and SDG&E separate portfolios¹⁵ represents a one-sided proposal that they purport would benefit core customers (who have historically not fully utilized their allocated storage

¹² Because of the correlation between storage inventory capacity and injection capacity, SCE's brief addresses inventory capacity. In other words, the amount of injection capacity will increase or decrease depending upon the amount of inventory capacity set by the CPUC. Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 3-4.

¹³ Tr., Vol. 5, page 787, line 28 to page 788, line 24 (Goldstein, SoCalGas/SDG&E) (May 15, 2007).

¹⁴ Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), p. 11.

¹⁵ DRA's Opening Brief, Section III.B.

assets) at the expense of noncore customers (who have a current storage need).¹⁶ DRA's discussion of storage is based on a confusion of the differences between storage inventory and injection and withdrawal capacity. The core's need for reliable service on any given day (in excess of pipeline capacity) is determined by the amount of level of withdrawal capacity available to the core and not the amount of storage capacity, and DRA is in agreement with the amount of withdrawal capacity proposed by the applicants. Further, DRA seems to make no distinction between the amount of storage needed for reliability purposes and the amount desired for price arbitrage purposes. The proposed storage targets provide core with more than enough storage injection and withdrawal rights to support a more than adequate level of reliability for core. Meanwhile, DRA gives short shrift to the substantial reliability and economic benefits to electric residential customers that would occur if additional storage assets were available to SCE and other gas-fired electric generators. DRA's arguments are also flawed because they completely ignore the efficiencies associated with the use of storage and capacity assets that will be gained as a result of the consolidation of the core procurement portfolios, even though they acknowledged these in efficiencies in Application No. 01-01-021.¹⁷ DRA's view misses the balance struck in the Application and should be rejected.

B. The Applicants Have Demonstrated That A Combined Core Inventory Level At 70 Bcf Is Sufficient To Meet Core Reliability Needs

DRA falsely asserts that the Applicants have not provided any study to support the proposed 70 Bcf combined core inventory level.¹⁸ Contrary to DRA's assertion, the Applicants have provided strong analysis to demonstrate that 70 Bcf is sufficient for the combined core

¹⁶ DRA's bias is evident by their Opening Brief as well where they cite to the Commission's alleged desire to protect core customers from both seasonal shortages and price spikes through storage. DRA's Opening Brief, p. 12. However, Decision No. 93-06-092 did not single out the need for "core" storage. The concern over seasonal shortages and price spikes with storage are relevant for all customers, notwithstanding DRA's reference in its Opening Brief to core customers only.

¹⁷ Exhibit 670, Rebuttal Testimony of Dr. Alexander (SCE), page 4 (quoting ORA's testimony from A. 01-01-021).

¹⁸ DRA's Opening Brief, p. 9.

reliability. Indeed, SCE witness Dr. Alexander provided a detailed analysis on the amount of core storage needed for reliability, based on historical data.¹⁹ He also analyzed DRA's position in the Comprehensive Settlement Agreement, which shows that the combined core inventory needed for reliability (e.g., excluding core arbitrage) is about 40 Bcf.²⁰ Therefore, as Dr. Alexander's analysis clearly demonstrates, a combined core inventory level of 70 Bcf is more than sufficient to ensure core's reliability needs are met. The physical gas in storage above the 40 Bcf needed for reliability would be available to the core for price arbitrage purposes.²¹

DRA, in contrast, never presented in the evidentiary hearings any analysis that the 83 Bcf combined core inventory level it proposes is the right level. Indeed, DRA relies heavily on a two-year old analysis by SoCalGas presented in R. 04-01-025.²² DRA ignores the more recent assessment of SoCalGas/SDG&E witness Mr. Goldstein in this proceeding that SoCalGas can handle the additional SDG&E core load without impacting core reliability. In addition, SCE witness Dr. Alexander testified that the analysis performed in R.04-01-025 examined only one aspect of core reliability, namely, whether storage inventory alone would be sufficient to meet core reliability. The reality is that SoCalGas historically has and continues to use a combination of flowing supplies and inventory to meet core reliability needs,²³ and it is simply improper for DRA to turn a blind eye to the relevant facts.

Finally, DRA's concern that flowing supplies are inferior to inventory storage²⁴ is a red herring. SCE generally agrees that flowing supplies, alone, are not adequate to meet core reliability needs, which is why the core need adequate storage inventory. However, flowing supplies are not adequate to meet noncore reliability needs either (including the needs of customers like SCE, which serve residential customers who are in turn SoCalGas core

¹⁹ See SCE's Opening Brief, pp. 13-14.

²⁰ See Table 5 in SCE's Opening Brief, p. 16. See also Section III.D of this Opening Brief, which contains a copy of Table 5 from SCE's Opening Brief.

²¹ Id.

²² DRA's Opening Brief, pp. 16-17. DRA indicates that the data was submitted in R.04-01-025 in June 2005. Exhibit 71, Direct Testimony of Sabino (DRA), p. 22.

²³ SCE's Opening Brief, pp. 13-15.

²⁴ DRA's Opening Brief, pp. 11.

customers). While SCE strongly believes that the core needs sufficient storage inventory to meet reliability needs, the Application mitigates the current critical lack of storage for noncore customers by making additional capacity available to the market for customers who need it.

C. The Use Of Flowing Supplies Will Not Result In A Decreased Withdrawal Rate

In support of its view that core storage inventory is superior to flowing supplies, DRA argues that withdrawal of gas in storage is more reliable than the purchase of flowing supplies because gas can be quickly withdrawn from storage when needed.²⁵ DRA's concern is a red herring. Both the Applicants and DRA agrees that core storage withdrawal will remain at 2,225 Mmcfd²⁶ and therefore the rate of withdrawal will not be affected by the Applicants' proposed combined core inventory of 70 Bcf.

D. The Core Retains A significant Level Of Storage For Arbitrage Under The Applicants' Proposed 70 Bcf Of Combined Core Inventory

Core storage inventory can be used for both reliability and arbitrage.²⁷ Fundamentally, SCE believes that the core should have sufficient storage inventory for reliability purposes (and has shown that the proposed 70 Bcf is more than sufficient). Storage for arbitrage purposes should be secondary, and only if reliability needs are met. And, under the Applicants' proposed 70 Bcf of combined core storage inventory, the core would have approximately 40 Bcf for reliability, with the balance of 30 Bcf for arbitrage purposes:

Core Inventory Level Needed For Reliability²⁸

²⁵ DRA's Opening Brief, pp. 11-12.

²⁶ Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pp. 2-3.

²⁷ See Table 5 in SCE's Opening Brief.

²⁸ See Table 5 in SCE's Opening Brief, pp. 16-17.

	Core Reliability and/or Balancing	Core Arbitrage
SoCalGas	35 Bcf ²⁹	20 Bcf ³⁰
SDG&E	4.5 Bcf ³¹	4.5 Bcf. ³²
Total Combined Core Inventory Needed For Reliability	39.5 Bcf	

DRA argues that gas in storage is more cost effective than flowing supplies because having a sufficient amount of core gas storage adds value for seasonal arbitrage.³³ Generally, SCE does not disagree that there is a value for seasonal arbitrage that can be attributable to gas storage as opposed to flowing supplies. However, this does not mean that the core should have set aside an amount of gas storage to perform arbitrage at the expense of other customers (e.g., the noncore) that have a need for storage for reliability purposes. SCE submits that the Commission should reject DRA's proposal, which would lead to providing core with more storage inventory than it needs simply for price arbitrage. This will result in higher storage costs to the core (and DRA has not presented any evidence that the net revenues from price arbitrage will be sufficient to cover these increased costs).

E. The Core Has The Discretion To Participate In The Unbundled Storage Program, Along With Other Alternatives

DRA expresses concerns that core customers should not have to compete with noncore customers in storage auctions.³⁴ However, one of the key principles advocated herein by Applicants is that there should be a level playing field for core and noncore customers by

²⁹ 35 Bcf is for core reliability and balancing agreed to by parties, including DRA, in the Comprehensive Settlement Agreement. Decision No. 01-12-018, Section III.D(2), mimeo p. 58.

³⁰ Since 35 Bcf of the 55 Bcf is for core reliability and balancing, the balance could be used for arbitrage. Decision No. 01-12-018, Section III.D(2), mimeo p. 58.

³¹ 4.5 Bcf is the approximate amount level needed for core reliability. Tr., Vol. 7, page 1078 (Dr. Alexander, SCE) (May 17, 2007).

³² Since 4.5 Bcf is the approximate amount level needed for core reliability, the balance could be used for arbitrage. Tr., Vol. 7, page 1078 (Dr. Alexander, SCE) (May 17, 2007).

³³ DRA's Opening Brief, pp. 13-14.

³⁴ DRA's Opening Brief, pp. 14 -15.

treating core customers, where possible, in same manner as noncore customers.³⁵ Indeed, the Commission should be mindful that many of SoCalGas' noncore customers, such as SCE and the Los Angeles Department of Water and Power, and wholesale customers (such as Long Beach) serve residential customers and participate in the unbundled storage program on an as-needed basis. The core's participation in the program would be at core's option and would ensure that proper price signals are set and that there would be a more efficient allocation and use of storage resources.

The Commission should also be aware that participation in the unbundled storage program is discretionary, and that there are many alternatives available to core procurement if they believe such participation is undesirable. In addition to storage, SCE witness Dr. Alexander observed that core reliability needs can be and have been met through a variety of ways:³⁶ (1) firm interstate supplies, (2) purchases of gas at the border from marketers or other end use customers,³⁷ (3) purchases of gas at the basin, which are brought into the SoCalGas system using interruptible capacity on the interstate pipelines;³⁸ (4) purchases of gas at the basin and which are brought into the SoCalGas system using firm transportation capacity releases by other shippers on the interstate pipelines, (5) purchases of gas in storage held by marketers or other end-use customers. Therefore, given the alternatives available to the core, DRA's concern should not be given any weight by the Commission in this application.

³⁵ For example, removing Hub services from core responsibility and control will provide a clear line of responsibility between these distinct utility functions. This will permit the core procurement function to operate on the transportation system on a basis that is functionally equivalent to other customers. It will also mitigate the ability and any incentive SoCalGas might have to manipulate the natural gas market to increase the demand for Hub services so as to provide a profit to SoCalGas through the shareholder award portion of its GCIM.

³⁶ Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 5 – 9.

³⁷ In GCIM year 11, 15% of SoCalGas' requirements were made through purchases at the border. Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 6-7.

³⁸ 169 Bcf was brought in through this method in 2006. Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), page 8.

F. DRA Has Not Provided Any Analysis That The Core's Costs Will Increase For System Imbalances Under the Proposed New Balancing Rules

The core has never been out of balance before both by definition and by their access to SoCalGas' abundant storage assets. Now, DRA is concerned, without proof, that costs to the core will increase because the core would be subject to the same balancing rules including imbalance charges for exceeding imbalance tolerances as noncore customers.³⁹ However providing a benefit to the core but not to the noncore without adequate justification (which DRA has not provided) would be discriminatory, and, as indicated above, one of the key principles advocated by Applicants is that there should be a level playing field for core and noncore customers by treating core customers, where possible, in same manner as noncore customers.⁴⁰

DRA's concern is purely based on speculation. DRA has not provided any analysis that shows that the core's costs will increase as a result of the new balancing rules. Even assuming that there are increased costs due to the new balancing rules, DRA has not shown whether these increased costs would be offset by the reduction in core costs associated with the decrease in core storage inventory. Under the Applicants' proposal to reduce the combined core storage inventory level to 70 Bcf, the core would no longer be paying for the cost associated with 13 Bcf. DRA has not provided any analysis that indicates whether the reduced cost associated with the core inventory will offset the potential increase in costs associated with the new balancing rules.

Relatedly, in DRA's Opening Brief, DRA makes the unsupported statement that the Applicants have acknowledged that the increased reliance on flowing supplies will result in

³⁹ DRA's Opening Brief, p. 18.

⁴⁰ For example, removing Hub services from core responsibility and control will provide a clear line of responsibility between these distinct utility functions. This will permit the core procurement function to operate on the transportation system on a basis that is functionally equivalent to other customers. It will also mitigate the ability and any incentive SoCalGas might have to manipulate the natural gas market to increase the demand for Hub services so as to provide a profit to SoCalGas through the shareholder award portion of its GCIM.

higher costs to customers.⁴¹ DRA's concern for core cost is noteworthy, but unsupported by the record in this proceeding.

G. DRA Misquotes, Misattributes, and Misunderstands Storage Issues

DRA's brief clearly demonstrates a confusion on their part of the difference between physical storage targets (the amount of gas which should be in storage), physical storage (the amount of gas that actually is in storage), gas loaned for repayment (the gas which has been taken out of storage, but which will be put back), gas storage capacity (the amount of gas which could be put in storage), injection capacity (the rate at which gas can be put in storage), and withdrawal capacity (the rate at which gas can be taken out of storage). It also demonstrates a lack of clarity on the difference between the use of storage for reliability purposes and the use for balancing purposes. It also fails to accurately reflect the record. For instance, DRA incorrectly states that under the Omnibus Settlement Agreement, the Applicants propose to "release all utilized firm access and storage capacity on an interruptible basis."⁴² DRA misquotes SCE's testimony. As clearly stated in SCE's testimony, in order to promote market efficiencies, unutilized firm access and storage capacity will be released on an interruptible basis.⁴³

Further, DRA appears to mix apples, oranges, and bananas with respect to storage inventory, injection, and withdrawal.⁴⁴ DRA used the misquote above in support of its concerns about inventory capacity, but the quote in question does not refer to inventory capacity. It refers to making injection and withdrawal capacity available. Storage inventory capacity relates to the physical volume of gas which can be placed in storage, while injection and withdrawal capacity relates to the rate at which gas can be moved into our out of inventory. The Applicants are

⁴¹ DRA's Opening Brief, p. 19.

⁴² DRA's Opening Brief, p. 20 (emphasis added). DRA also mistakenly attributes this quote to SCE witness Dr. Alexander in its footnote 53 on page 20, when the correct witness is SCE witness Mr. Pickett.

⁴³ Exhibit 47, Direct Testimony of Pickett (SCE), page 8, lines 21-23.

⁴⁴ DRA's Opening Brief, p. 20.

proposing that the combined core storage inventory capacity would remain at 70 Bcf, regardless whether or not the core uses the capacity. In other words, if the core used only 60 Bcf of inventory capacity, the balance of 10 Bcf would be retained by the core and not sold on an interruptible basis. Thus, under the Omnibus Settlement Agreement, unused core storage injection capacity and core storage withdrawal capacity would be made available on an interruptible basis.

In addition, DRA appears to mix apples and oranges with respect to the issues in the Border Price OII.⁴⁵ The issue in the Border Price OII related to SoCalGas' claim that they had met certain storage targets based on the amount of physical gas actually storage in its system plus virtual storage they would receive in the future from repayments of gas loaned out under SoCalGas' Park and Loan program.⁴⁶ In that proceeding, SCE expressed its belief that the scheduling of the repayments created excessive stress on the system. Thus, SCE witness Mr. Pickett's statements with respect to the Border Price OII cited in DRA's Opening Brief are correctly attributable to Mr. Pickett,⁴⁷ but are unrelated to and inappropriately used by DRA to support its position on the core storage inventory level.

Finally, DRA appears to have a fundamental misunderstanding of the difference between reliability and the balancing functions. SCE witness Mr. Pickett did respond that it is doubtful that interruptible storage capacity would be available 365 days out of the year, when questioned about pages 6-7 of his direct testimony. But, Mr. Pickett was referring to "enhanced imbalance trading"⁴⁸ not to storage inventory levels (which is why injection and withdrawal capacity are the issues, not inventory capacity). DRA seems to have misread this to conclude that the combined core inventory capacity should not be reduced from 83 Bcf (as proposed by DRA) to 70 Bcf (as proposed by the Applicants).⁴⁹ DRA's conflation of the two issues shows a

⁴⁵ DRA's Opening Brief, p. 20.

⁴⁶ See Proposed Decision of ALJ Terkeurst on the first phase of I. 02-11-040 (November 16, 2004). The CPUC never issued a final decision for the first phase of I. 02-11-040.

⁴⁷ DRA's Opening Brief, p. 20.

⁴⁸ Exhibit 47, Direct Testimony of Pickett (SCE), page 6 line 24.

⁴⁹ DRA's Opening Brief, p. 20.

fundamental misunderstanding of the different uses of storage, and their argument should be disregarded.

H. SCE Supports Storage Expansion, But Expansions Will Not Be Immediate

DRA correctly notes that SCE supports storage expansion in California, given the present shortage of storage available to noncore customers.⁵⁰ In summary, SCE strongly believes:

- The core should have adequate storage for core reliability needs.
- If the core has excess storage, there are market inefficiencies.
- A combined core storage inventory level of 70 Bcf is more than adequate to meet the core's reliability needs, in addition to providing core storage inventory for arbitrage and other purposes.

However, while SCE supports storage expansion, SCE does not believe that such expansion would be achievable in the immediate future. Expansions would require regulatory approval (from the CPUC and environmental agencies), currently unknown costs, and significant construction times. New construction would, therefore, probably take several years. Therefore, while DRA's suggestion is appreciated, it is not immediately helpful in the present situation.

IV.

WINTER HEDGES SHOULD BE EXCLUDED FROM THE GCIM

Contrary to Coral's assertion that the Commission has not established principles that address hedging as part of the gas utilities' core procurement strategy,⁵¹ as indicated in SCE's Opening Brief, the Commission has consistently determined since 2005 that financial transactions used by the gas utilities to hedge natural gas price should be excluded from the gas utilities' gas cost incentive mechanisms.⁵² Nothing has changed since the Commission issued its

⁵⁰ DRA's Opening Brief, p. 21.

⁵¹ Coral's Opening Brief, pp. 22-23.

⁵² See SCE's Opening Brief, pp. 18-19, citing D. 05-10-015, D. 05-10-043, D. 06-08-027, and the most recent CPUC decision, D. 07-06-013.

most recent decision in June 2007 indicating that financial hedges should be excluded from Pacific Gas and Electric Company's gas procurement incentive mechanism.⁵³ DRA appears to have somewhat conceded this issue and is now requesting in its Opening Brief that such exclusion be limited to the term of the settlement, or May 30, 2011.⁵⁴ DRA's proposed limitation is inconsistent with the balance achieved in the Application and should be rejected. As indicated in SCE's testimony and Opening Brief, the gas incentive mechanism was not designed to accommodate hedging activities in a changing market.⁵⁵ Gas hedging is not consistent with the goal of a gas cost incentive mechanism in that hedging lowers volatility, not costs.⁵⁶

V.

THE COMMISSION SHOULD REJECT CORAL'S PROPOSED CORE PORTFOLIO DIVERSITY PROGRAM

Coral's proposed Core Portfolio Diversity Program seeks to mitigate SoCalGas' market power, which was raised as an issue by SCE in SoCalGas' gas cost incentive mechanism proceedings as well as the Border Price OII.⁵⁷ However, even if the Commission were to agree that having third parties supply gas for the core would mitigate SoCalGas' market power, Coral's proposal is not well vetted and should be rejected.

SCE agrees with the concern raised by SoCalGas/SDG&E in its Opening Brief that Coral's proposal leaves the Commission with virtually no oversight of the third party suppliers.⁵⁸ As indicated by Coral's witness Mr. Dyer:

“A Nobody I'm aware of as a marketer is willing to go under CPUC jurisdiction.
Q. Why not?”

⁵³ Decision No. 07-06-013.

⁵⁴ DRA's Opening Brief, p. 22.

⁵⁵ SCE's Opening Brief, pp. 19-20.

⁵⁶ Id.

⁵⁷ Coral's Opening Brief, pp. 7 – 10.

⁵⁸ SoCalGas/SDG&E's Opening Brief, p. 61. See Tr., Vol. 7, p. 1031-1032 (Dyer, Coral) where Coral indicates that the third party gas suppliers would not have the same posting or disclosure requirements as SoCalGas

A. Because of the cost. Because of the oversight. The potential for auditing of the books. Just as we don't separate our books out that way, the . . . just the difficulties with it. We already have – I can speak for Coral in this regard. We have a power marketing license with the FERC and a gas marketing license with the FERC. That's our regulatory oversight. We're not looking for another layer.”⁵⁹

SCE also finds it problematic that, as pointed out by SoCalGas/SDG&E, there is no exit strategy available in case Coral's radical approach fails.⁶⁰

SCE believes other flaws exist with Coral's approach, including the lack of oversight over the use of SoCalGas' storage assets. For example, under Coral's proposal, no requirements are placed on the suppliers to use the existing assets for the core. As indicated by Coral's witness Mr. Dyer, “You guys [SoCalGas] have some pretty nice stuff.”⁶¹ In addition, SCE is concerned that the very same concerns that Coral raised about SoCalGas' market power could exist if significant restrictions (such as size) are not placed on the suppliers.

VI.

THE CITY OF LONG BEACH IS INCORRECT IN ASSERTING THAT THE APPLICATION DOES NOT PROVIDE SDG&E WITH ADDITIONAL STORAGE CAPACITIES. IT IS ALSO INCORRECT IN ITS UNDERSTANDING OF CORE PARITY

SCE generally supports the comments of SoCalGas/SDG&E in response to the City of Long Beach's (“Long Beach”) core parity proposal.⁶² In its Opening Brief, Long Beach erroneously claims that the Application proposes that “additional capacities” be set aside for the benefit of SDG&E and its SDG&E and its core customers.

⁵⁹ Tr., Vol. 7, p. 1022 (Dyer, Coral).

⁶⁰ SoCalGas/SDG&E's Opening Brief, p. 60.

⁶¹ Tr., Vol. 7, p. 1020, line 18 (Dyer, Coral).

⁶² SoCalGas/SDG&E's Opening Brief, pp. 64-65.

Long Beach is incorrect. As indicated below in the tables from SCE’s Opening Brief,⁶³ both SoCalGas and SDG&E each have existing core inventory, injection, and withdrawal capacity assigned to it.

Core Storage Inventory Capacity⁶⁴

SoCalGas Current	SDG&E Current	Combined Current	Settlement (combined core)	DRA’s position (combined core)
70 Bcf 4 Bcf for CARE ⁶⁵	9 Bcf	83 Bcf	70 Bcf	83 Bcf

Core Storage Injection⁶⁶

SoCalGas Current	SDG&E Current	Combined Current	Settlement (combined core)	DRA’s position (combined core)
327 MMcf/d	42 MMcf/d	369 MMcf/d	327 MMcf/d	368 MMcf/d

Core Storage Withdrawal⁶⁷

SoCalGas Current	SDG&E Current	Combined Current	Settlement (combined core)	DRA’s position
1935 MMcf/d	297 MMcf/d	2232 Bcf	2,225 MMcf/d	2,225 MMcf/d

As a result of the combined core consolidation, the combined core will be assigned less core inventory and injection capacity by the Application, while the withdrawal capacity for SDG&E remains virtually the same.

The City of Long Beach also says that the Commission has “long supported the principal of core parity.”⁶⁸ If this is true, then the current situation must be consistent with that principal. Under the current situation SDG&E competes for gas storage and pays market price, whereas SoCalGas’ core does not. Logically, if the Commission permits this and is supporting the principal of market parity, then having one party compete in the market and not another is consistent with market parity. Further, since the core consolidation proposed in the application does not disadvantage Long Beach (or other wholesale customers), it merely fails to provide

⁶³ See SCE’s Opening Brief, pp. 12.

⁶⁴ Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 2-3.

⁶⁵ Of the 4 Bcf storage inventory capacity reserved for core, 2.75 bcf core storage inventory is currently banked for the core.

⁶⁶ Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 2-3.

⁶⁷ Exhibit 60, Rebuttal Testimony of Dr. Alexander (SCE), pages 2-3.

⁶⁸ Long Beach’s Opening Brief, p. 5.

them with an advantage which they want under the current pricing structure (but might not want if the relative prices of storage were different), and it would be capricious to withhold approval of changes which would benefit customers and make no one worse off.⁶⁹

VII.

CONCLUSION

Wherefore, for the above reasons, the Commission should approve the changes to the operational practices and services offered by SoCalGas and SDG&E in this Application.

Respectfully submitted,

DOUGLAS K. PORTER
GLORIA M. ING

/s/

By: Gloria M. Ing
Attorneys for
SOUTHERN CALIFORNIA EDISON COMPANY

2244 Walnut Grove Avenue
Post Office Box 800
Rosemead, California 91770
Telephone: (626) 302-1999
Facsimile: (626) 302-3990
E-mail: Gloria.Ing@sce.com

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⁶⁹ What economists call a “Pareto Improvement” in social welfare.

CERTIFICATE OF SERVICE

I hereby certify that, pursuant to the Commission's Rules of Practice and Procedure, I have this day served a true copy of **REPLY BRIEF OF SOUTHERN CALIFORNIA EDISON COMPANY (U338-E)** on all parties identified on the attached service list(s). Service was effected by one or more means indicated below:

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Executed this **20th day of July, 2007** at Rosemead, California.

/s/

Raquel Ippoliti

Project Analyst

SOUTHERN CALIFORNIA EDISON COMPANY

2244 Walnut Grove Avenue

Post Office Box 800

Rosemead, California 9177

A.06-08-026

Friday, July 20, 2007

CASE ADMINISTRATION
SOUTHERN CALIFORNIA EDISON COMPANY
2244 WALNUT GROVE AVENUE
ROSEMEAD, CA 91770
A.06-08-026

FRANCISCO V. AGUILAR
SOUTHWEST GAS CORPORATION
PO BOX 98510
LAS VEGAS , NV 89193-8510
A.06-08-026

Joyce Alfton
CALIF PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
AREA 4-A
SAN FRANCISCO, CA 94102-3214
A.06-08-026

MICHAEL ALEXANDER
SOUTHERN CALIFORNIA EDISON CO.
2244 WALNUT GROVE AVENUE
ROSEMEAD, CA 91770
A.06-08-026

JEANNE B. ARMSTRONG
ATTORNEY AT LAW
GOODIN MACBRIDE SQUERI RITCHIE & DAY
LLP
505 SANSOME STREET, SUITE 900
SAN FRANCISCO, CA 94111
A.06-08-026

BRAD N. BAKER
BAKER, BURTON & LUNDY
515 PIER AVENUE
HERMOSA BEACH, CA 90254
A.06-08-026

R. THOMAS BEACH
PRINCIPAL
CROSSBORDER ENERGY
2560 NINTH STREET, SUITE 213A
BERKELEY, CA 94710-2557
A.06-08-026

KENNETH J BRENNAN
PACIFIC GAS AND ELECTRIC COMPANY
77 BEALE STREET MAILCODE B9A
SAN FRANCISCO, CA 94105
A.06-08-026

JOHN BURKHOLDER
BETA CONSULTING
2023 TUDOR LANE
FALLBROOK, CA 92028
A.06-08-026

RONALD S. CAVALLERI
SEMPRA ENERGY UTILITIES
555 W. FIFTH STREET, GT14D6
LOS ANGELES, CA 90013-1011
A.06-08-026

CENTRAL FILES
SEMPRA ENERGY UTILITIES
555 W. FIFTH STREET, GT14D6
LOS ANGELES, CA 90013-1011
A.06-08-026

MICHAEL P. FLORIO
ATTORNEY AT LAW
THE UTILITY REFORM NETWORK (TURN)
711 VAN NESS AVENUE, SUITE 350
SAN FRANCISCO, CA 94102
A.06-08-026

BRUCE FOSTER
VICE PRESIDENT
SOUTHERN CALIFORNIA EDISON COMPANY
601 VAN NESS AVENUE, STE. 2040
SAN FRANCISCO, CA 94102
A.06-08-026

JAIRAM GOPAL
SOUTHERN CALIFORNIA EDISON
2244 WALNUT GROVE, QUAD 1C-G01
ROSEMEAD, CA 91770
A.06-08-026

YVONNE GROSS
SEMPRA GLOBAL
101 ASH STREET, HQ08C
SAN DIEGO, CA 92101
A.06-08-026

JEFFERY D. HARRIS
ATTORNEY AT LAW
ELLISON, SCHNEIDER & HARRIS LLP
2015 H STREET
SACRAMENTO, CA 95814
A.06-08-026

MARCEL HAWIGER
ATTORNEY AT LAW
THE UTILITY REFORM NETWORK
711 VAN NESS AVENUE, SUITE 350
SAN FRANCISCO, CA 94102
A.06-08-026

GREGORY HEALY
SEMPRA UTILITIES
555 WEST FIFTH STREET, 14TH FLR. -
GT14D6
LOS ANGELES, CA 90013
A.06-08-026

A.06-08-026

Friday, July 20, 2007

DAVID L. HUARD
ATTORNEY AT LAW
MANATT, PHELPS & PHILLIPS, LLP
11355 WEST OLYMPIC BOULEVARD
LOS ANGELES, CA 90064
A.06-08-026

EVELYN KAHL
ATTORNEY AT LAW
ALCANTAR & KAHL LLP
120 MONTGOMERY STREET, SUITE 2200
SAN FRANCISCO, CA 94104
A.06-08-026

RANDALL W. KEEN
ATTORNEY AT LAW
MANATT PHELPS & PHILLIPS, LLP
11355 WEST OLYMPIC BLVD.
LOS ANGELES, CA 90064
A.06-08-026

GREGORY KLATT
DOUGLASS & LIDDELL
21700 OXNARD STREET, SUITE 1030
WOODLAND HILLS, CA 91367-8102
A.06-08-026

MARC KOLB
PACIFIC GAS & ELECTRIC COMPANY
245 MARKET STREET
SAN FRANCISCO, CA 94105
A.06-08-026

WALTER J. LACK
ESQUIRE
ENGSTROM LIPSCOMB & LACK
10100 SANTA MONICA BLVD., 16TH FLOOR
LOS ANGELES, CA 90067-4107
A.06-08-026

Diana L. Lee
CALIF PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
ROOM 4300
SAN FRANCISCO, CA 94102-3214
A.06-08-026

JOHN LESLIE
ATTORNEY AT LAW
LUCE, FORWARD, HAMILTON & SCRIPPS
11988 EL CAMINO REAL, SUITE 200
SAN DIEGO, CA 92130
A.06-08-026

MARTIN A. MATTES
ATTORNEY AT LAW
NOSSAMAN GUTHNER KNOX & ELLIOTT,
LLP
50 CALIFORNIA STREET, 34TH FLOOR
SAN FRANCISCO, CA 94111
A.06-08-026

KEITH MCCREA
ATTORNEY AT LAW
SUTHERLAND, ASBILL & BRENNAN
1275 PENNSYLVANIA AVENUE, NW
WASHINGTON , DC 20004-2415
A.06-08-026

ROBERT B. MCLENNAN
ATTORNEY AT LAW
PACIFIC GAS AND ELECTRIC COMPANY
77 BEALE STREET
SAN FRANCISCO, CA 94105
A.06-08-026

M. BRIAN MCMAHON
LAW OFFICES OF M. BRIAN MCMAHON
633 WEST FIFTH STREET, SUITE 1700
LOS ANGELES, CA 90071
A.06-08-026

MARCIE MILNER
CORAL ENERGY RESOURCES, LP
4445 EASTGATE MALL, STE. 100
SAN DIEGO, CA 92121
A.06-08-026

Ed Moldavsky
CALIF PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
ROOM 5125
SAN FRANCISCO, CA 94102-3214
A.06-08-026

BETH MUSICH
SEMPRA ENERGY UTILITIES
555 W. FIFTH STREET, GT14D6
LOS ANGELES, CA 90013-1011
A.06-08-026

STEVEN C. NELSON
ATTORNEY AT LAW
SEMPRA GLOBAL
101 ASH STREET
SAN DIEGO, CA 92101-3017
A.06-08-026

EDWARD W. O'NEILL
ATTORNEY AT LAW
DAVIS WRIGHT TREMAINE LLP
505 MONTGOMERY STREET, SUITE 800
SAN FRANCISCO, CA 94111-6533
A.06-08-026

Marion Peleo
CALIF PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
ROOM 4107
SAN FRANCISCO, CA 94102-3214
A.06-08-026

A.06-08-026

Friday, July 20, 2007

NORMAN A. PEDERSEN
ATTORNEY AT LAW
HANNA & MORTON
444 S. FLOWER STREET, SUITE 1500
LOS ANGELES, CA 90071
A.06-08-026

Robert M. Pocta
CALIF PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
ROOM 4205
SAN FRANCISCO, CA 94102-3214
A.06-08-026

DOUGLAS PORTER
ATTORNEY AT LAW
SOUTHERN CALIFORNIA EDISON COMPANY
2244 WALNUT GROVE AVENUE
ROSEMEAD, CA 91770
A.06-08-026

Thomas R. Pulsifer
CALIF PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
ROOM 5016
SAN FRANCISCO, CA 94102-3214
A.06-08-026

Ramesh Ramchandani
CALIF PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
ROOM 4102
SAN FRANCISCO, CA 94102-3214
A.06-08-026

LYNN CHARLES RISER
PACIFIC GAS AND ELECTRIC COMPANY
77 BEALE STREET, MC B9A
SAN FRANCISCO, CA 94105
A.06-08-026

Pearlie Sabino
CALIF PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
ROOM 4209
SAN FRANCISCO, CA 94102-3214
A.06-08-026

SEEMA SRINIVASAN
ATTORNEY AT LAW
ALCANTAR & KAHL, LLP
120 MONTGOMERY STREET, SUITE 2200
SAN FRANCISCO, CA 94104
A.06-08-026

ALANA STEELE
ATTORNEY AT LAW
HANNA AND MORTON, LLP
444 SOUTH FLOWER STREET, SUITE 1500
LOS ANGELES, CA 90071-2916
A.06-08-026

KAREN TERRANOVA
ALCANTAR & KAHL, LLP
120 MONTGOMERY STREET, STE 2200
SAN FRANCISCO, CA 94104
A.06-08-026

PATRICIA THOMPSON
SUMMIT BLUE CONSULTING
2920 CAMINO DIABLO, SUITE 210
WALNUT CREEK, CA 94597
A.06-08-026

MICHAEL THORP
ATTORNEY AT LAW
SAN DIEGO GAS & ELECTRIC CO./SOCAL
GAS
555 W. 5TH STREET
LOS ANGELES, CA 90013
A.06-08-026

BILL TOBIN
SEMPRA GLOBAL
101 ASH STREET, HQ08C
SAN DIEGO, CA 92101
A.06-08-026

TREG TREMONT
ATTORNEY AT LAW
DAVIS WRIGHT TREMAINE, LLP
505 MONTGOMERY STREET, SUITE 800
SAN FRANCISCO, CA 94111-6533
A.06-08-026

ELIZABETH WESTBY
ALCANTAR & KAHL LLP
120 MONTGOMERY STREET, SUITE 2200
SAN FRANCISCO, CA 94104
A.06-08-026

S. NANCY WHANG
MANATT, PHELPS & PHILLIPS, LLP
11355 W. OLYMPIC BLVD.
LOS ANGELES, CA 90064
A.06-08-026

GREGGORY L. WHEATLAND
ATTORNEY AT LAW
ELLISON, SCHNEIDER & HARRIS, LLP
2015 H STREET
SACRAMENTO, CA 95814
A.06-08-026

STEVE WILLIAMS
SOUTHWEST GAS CORPORATION
PO BOX 98510
LAS VEGAS, NV 89193-8510
A.06-08-026

A.06-08-026

Friday, July 20, 2007

HUGH YAO
SOUTHERN CALIFORNIA GAS COMPANY
555 W. 5TH ST, GT22G2
LOS ANGELES, CA 90013
A.06-08-026

CATHERINE E. YAP
BARKOVICH & YAP, INC.
PO BOX 11031
OAKLAND, CA 94611
A.06-08-026

MARZIA ZAFAR
SOUTHERN CALIFORNIA GAS
COMPANY/SDG&E
601 VAN NESS AVENUE, SUITE 2060
SAN FRANCISCO, CA 94102
A.06-08-026

MRW & ASSOCIATES, INC.
1814 FRANKLIN STREET, SUITE 720
OAKLAND, CA 94612
A.06-08-026